STATE OF NORTH DAKOTA

BISMARCK, NORTH DAKOTA

REPORT OF LIMITED SCOPE EXAMINATION

OF

NORTH DAKOTA VISION SERVICES, INC.
FARGO, NORTH DAKOTA

OCTOBER 2008

STATE OF NORTH DAKOTA

DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report ofLimited Scope Examination of the

North Dakota Vision Services, Inc.

Fargo, North Dakota

with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at my office in the City of Bismarck, this 5th day of January, 2009.

Adam W. Hamm
Commissioner of Insurance

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November 5, 2008

Honorable Adam W. Hamm
Commissioner of Insurance
State of North Dakota
600 East Boulevard
Bismarck, ND 58505-0320

Commissioner Hamm:

A limited scope examination was made of matters impacting the financial condition of the

North Dakota Vision Services, Inc.
Fargo, North Dakota

North Dakota Vision Services, Inc., hereinafter referred to as the "Company", was last examined as of December 31, 2004, by representatives of the North Dakota Insurance Department.

This report results from a limited-scope examination, and is not intended to communicate all matters of importance for an understanding of the company's financial condition.

This limited scope examination was conducted to review the Company's liability for Premium Deficiency Reserves as of December 31, 2007, the adjustments made to the Premium Deficiency Reserves as of June 30, 2008, and to determine the Company's compliance with regulatory requirements for establishing a Premium Deficiency Reserve.

SCOPE OF EXAMINATION

The limited scope financial examination, as authorized under N.D.C.C. § 26.1-17-32, was conducted in accordance with the guidelines and procedures in the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook* and in accordance with North Dakota insurance laws and regulations, the NAIC's *Accounting Practices and Procedures Manual*, and the NAIC's *Annual Statement Instructions.*

The Department retained the actuarial firm of Lewis & Ellis, Inc. to perform the following procedures:

- Review and evaluate the Company's internal testing, and related documentation, by which the Company determined its need or requirement to recognize a Premium Deficiency Reserve in its statutory financial statements as of 12/31/2007 and 6/30/2008.

- Determine whether the Company's calculations of a Premium Deficiency Reserve, as of 12/31/2007 and 6/30/2008, are based on reasonable and credible actuarial methods and assumptions and whether such bases are adequately documented.

- Determine whether the Company's calculations of a Premium Deficiency Reserve, as of 12/31/2007 and 6/30/2008, includes only expenses attributable to fully-insured policies and excludes expenses attributable to Administrative Services Contract uninsured plans and the uninsured portion of partially insured plans.

- Determine whether the Company is in compliance with SSAP No. 54 of the NAIC's *Accounting Practices and Procedures Manual*, with the NAIC's *Health Reserves Guidance Manual* and the ASB's *Actuarial Standards of Practice* in establishing a Premium Deficiency Reserve.

EXAMINATION FINDINGS

The Company reported a liability for Premium Defidency Reserves as follows:

Annual Statement as of 12/31/2007	Aggregate health policy reserves	$ 712,000
Quarterly Statement as of 6/30/2008	Aggregate health policy reserves	$ 271,479

The Actuarial Memorandum prepared by consulting actuary Brian Rankin of Lewis & Ellis, Inc. is attached and is incorporated into this Report by reference. The results of the actuarial review and evaluation of Premium Deficiency Reserves as of December 31, 2007, the adjustments made to the Premium Deficiency Reserves as of June 30, 2008, the Company's internal testing, related documentation, actuarial methods and assumptions, and compliance with regulatory requirements are addressed in the Actuarial Memorandum.

The following exceptions were noted in the Actuarial Memoandum:

- The Company failed to adhere to the NAIC's *Health Reserves Guidance Manual* when developing the contract groupings in establishing a Premium Deficiency Reserve.
- The Company failed to provide the support and documentation of the expenses assumed in the calculation of the Premium Deficiency Reserve.
- The Company's Premium Deficiency Reserve as of 12/31/2007 was understated by $172,000.
- The Company's Premium Deficiency Reserve as of 6/30/2008 failed to reflect new deficiencies that have arisen.

Contract Groupings

The Company utilized a contract grouping method for its Premium Deficiency Reserve calculation that fails to reflect:

1. The difference in the risk associated with the self-funded and fully insured businesses.
2. The 2007 Annual Statement does not record the self-funded premium, income and expenses.
3. The NAIC's *Health Reserves Guidance Manual* states that under certain circumstances, SSAP No 5 requires a liability similar to Premium Deficiency Reserves for Administrative Services Only (self-funded plans) when the administrative fees are not sufficient to cover expenses for the reminder of the contract period.

It is recommended that the Company utilize a contract grouping method for calculating Premium Deficiency Reserves that differentiates fully insured business and self-funded business.

Expense Documentation

The Company did not provide documentation to support that the administrative fees charged to self-funded plans are the actual expenses for administrating its self-funded plans. The Company assumes that actual expenses for self-funded plans are set equal to the fees charged to the plans. A review of the assumed expenses for the self-funded plans compared to the fully insured plans reveals a large difference in the percentages charged to the selfinsured plans.

Plan	Expenses	Income	Expense Ratio
Self-Insured	$258,572	$2,359,491	11.0%
Fully Insured	774,428	2,992,737	25.9%

The Company also did not provide documentation to support the assumption in its Premium Deficiency Reserve calculation that operating expenses as a percentage of income for the fully insured plans would be reduced during the contract period of 2008, 2009, and 2010.

It is recommended that an independent functional cost study be performed, under the supervision of the Department, to determine whether the administrative fees charged to self-funded plans accurately reflect the actual expenses for administrating the Company's self-funded plans.

It is recommended that the Company adopt procedures to determine actual expenses on an ongoing basis for administrating its self-funded plans and retain documentation to support such actual expenses.

It is also recommended that the Company prepare detailed documentation to support its expense assumption utilized in the calculation of Premium Deficiency Reserves.

Premium Deficiency Reserves at 12/31/2007

The consulting actuary calculated an independent estimate for the Premium Deficiency Reserves at 12/31/2007 utilizing the subscriber income, incurred claims and other income assumptions from the Company's calculation, but revised operating expenses for the projected contract period to reflect an expense savings limited to 0.75% per year. The revised amount of Premium Deficiency Reserves is $883,861, or $171,861 greater than the $712,000 liability reported by the Company.

The $171,861 understatement of the Company's Premium Deficiency Reserve as of 12/31/2007 serves to reduce the Company's reported capital and surplus by $171,861 to $259,468, resulting in a significant impact to the Risk-Based Capital Report filed by the Company.

Pursuant to N.D.C.C. § 26.1-03.2-02(4), the Commissioner shall adjust the Risk-Based Capital Report if, in the judgment of the Commissioner, the report filed by the Company is inaccurate. An adjusted Risk-Based Capital Report will trigger the Regulatory Action Level as summarized below:

Authorized Control Level (ACL) RBC	$ 178,957
Total Adjusted Capital (TAC)	$ 259,468
Ratio of TAC to ACL	145%
Level of Action	Regulatory Action Level

A Regulatory Action Level requires the Company to submit a risk-based capital plan, defined by law as a comprehensive financial plan containing elements specified in N.D.C.C. § 26.1-03.2-03(2). A Regulatory Action Level also permits the Commissioner to take various actions to formulate a corrective order under the provisions of N.D.C.C. § 26.1-03.2-04.

This examination recommends that a corrective plan be formulated and implemented to restore the Company's capital and surplus above the risk-based capital levels required by law.

Premium Deficiency Reserves as of 6/30/2008

The Company did not provide support or documentation for the development of the Premium Deficiency Reserves as of 6/30/2008. The consulting actuary noted the June 2008 financials reveal loss ratios that exceed the assumed loss ratios in Premium Deficiency Reserve calculations. The actuary concluded that the liability for Premium Deficiency Reserves as of 6/30/2008 does not reflect new deficiencies that have arisen given the fact that more losses through June 2008 were recognized than were originally projected for the entire calendar year and the fact that the loss ratio is higher than predicted.

CONCLUSION

This limited scope examination has identified a significant increase to the liability for Premium Deficiency Reserves reported by the Company and a corresponding decrease to the Company's capital and surplus. The resulting balance sheet adjustments subject the Company to a Regulatory Action Level event under the Risk-Based Capital provisions of N.D.C.C. Chapter 26.1-03.2.

The cooperation extended by the Company's actuary and employees of Noridian Mutual Insurance Company during the course of the examination is gratefully acknowledged.

Carole Kessel

Carole Kessel, Chief Examiner
North Dakota Insurance Department

RECOMMENDATIONS

It is recommended that the Company utilize a contract grouping method for calculating Premium Deficiency Reserves that differentiates fully insured business andself-funded business.

It is recommended that an independent functional cost study be performed, under the supervision of the Department, to determine whether the administrative fees charged to self-funded plans accurately reflect the actual expenses for administrating the Company's self-funded plans.

It is recommended that the Company adopt procedures to determine actual expenses on an ongoing basis for administrating its self-funded plans and retain documentation to support such actual expenses.

It is also recommended that the Company prepare detailed documentation to support its expense assumption utilized in the calculation of Premium Deficiency Reserves.

This examination recommends that a corrective plan be formulated and implemented to restore the Company's capital and surplus above the risk-based capital levels required by law.

ACTUARIAL MEMORANDUM
ON THE FINANCIAL EXAMINATION OF

NORTH DAKOTA VISION SERVICES, INC.

AS OF DECEMBER 31, 2007

Lewis & Ellis, Inc.
Actuaries & Consultants

Brian D. Rankin, F.S.A., M.A.A.A.

Actuarial Memorandum on the Financial Examination of North Dakota Vision Services, Inc. As of December 31, 2007

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I. Executive Summary

Lewis & Ellis, Inc. were retained by the North Dakota Department of Insurance to review North Dakota Vision Services, Inc. (the "Company" or "Vision") as of December 31, 2007. Our assignment was to review the Company's premium deficiency reserves as of 12/31/2007 and the adjustments made to the premium deficiency reserves as of 6/30/2008. We were also to review and evaluate the Company's internal testing, related documentation, actuarial methods and assumptions. We were also to determine whether the Company is in compliance with SSAP No. 54 of the National Association of Insurance Commissioner's (NAIC) *Accounting Practices and Procedures Manual*, with the NAIC's *Health Reserves Guidance Manual* and the ASB's *Actuarial Standards of Practice* in establishing a Premium Deficiency Reserve. As part of our analysis, L&E calculated an independent estimate for the premium deficiency reserve (PDR). The PDR provision alone accounts for 73% of Vision's total liabilities.

We made the following observations regarding the development and reasonableness of the Company's premium deficiency reserve reported in the 2007 Annual Statement:

- The Company failed to adhere to the NAIC's *Health Reserves Guidance Manual* when developing the contract groupings in establishing a premium deficiency reserve.

- The Company failed to provide the support and documentation of the expenses assumed in the calculation of the premium deficiency reserve.

- The Company's premium deficiency reserve as of 12/31/2007 was understated by $172,000.

- The Company's premium deficiency reserve as of 6/30/2008 failed to reflect new deficiencies that have arisen.

II. Purpose and Scope

Lewis & Ellis, Inc. (L&E) were retained by the North Dakota Department of Insurance ("NDDOI") to review North Dakota Vision Services, Inc. ("Company" or "Vision") as of December 31, 2007. Our assignment was to review the Company's actuarial liabilities.

Specifically, our assignment was to review the following actuarial liability disclosed in the December 31, 2007 statement:

1. Aggregate health policy reserves (Page 3, Line 4) $712,000

During our review we examined the actuarial assumptions and actuarial methods used in determining Vision's established liabilities.

In addition, we reviewed:
- The Company's compliance with accounting and actuarial standards of practice;
- The Company's internal testing and related documentation.

Limits on Distribution and Utilization

This report has been prepared for the use of the North Dakota Department of Insurance regarding the financial examination of North Dakota Vision Services, Inc. The data and information presented is not appropriate for any other purpose.

This report may not be distributed to any other party without prior consent of Lewis & Ellis, Inc. Any user of this report must possess a certain level of expertise in actuarial science and/or insurance so as not to misinterpret the data presented. Any distribution of this report should be made in its entirety. In addition, any third party with access to this report acknowledges, as a condition of receipt, that L&E does not make any representations or warranties as to the accuracy or completeness of the material. Any third party with access to these materials cannot bring suit, claim, or action against L&E, under any theory of law, related in any way to this material.

Lewis & Ellis are available to answer any questions that may be raised by this report. Please direct any inquiries to Brian Rankin.

Confidentiality of Review

L&E recognizes that in the performance of the work, we acquired or had access to records and information considered confidential by the NDOI and Vision. L&E took steps to comply with all laws and regulations relating to confidentiality and privacy.

Reliances

L&E's work was based upon data and information obtained through the North Dakota Department of Insurance as well as Vision. Lewis & Ellis did not perform a detailed review of the data provided. We relied upon the NDDOI and Vision to attest to the accuracy of the information provided. We did review the data for overall appropriateness. If there is any material inaccuracies in the data provided, the conclusions reached in this report may be invalid.

Acknowledgements

L&E would like to thank the parties at Vision and NDDOI who provided the data and information needed for our review.

III. Reserve Adequacy Analysis

Our assignment was to review the adequacy of the following actuarial liability item in Vision's Statutory Statement for the calendar year ended December 31, 2007:

1. Aggregate health policy reserves (Page 3, Line 4) $712,000

Aggregate Health Policy Reserves

Aggregate policy reserves reflect that premiums cover future liabilities in addition to current claim costs and expenses. These reserves include additional policy reserves (including additional reserves due to asset/liability testing), unearned premium reserves, and reserves for experience rating refunds.

The Company's aggregate health policy reserves as of 12/31/2007 consisted of the following reserve provisions:

Reserve Provision	Amount
Unearned Premium Reserves	$0
Additional Policy Reserves* (including adequacy reserves)	712,000
Experience Rating Refunds	0
Aggregate Health Policy Reserves	$712,000

* Includes asset adequacy and/or premium deficiency reserves

<u>Additional Policy Reserves</u>

These reserves are required for health insurance coverages for which the present value of future benefits exceeds the present value of future valuation net premiums. This is typically the case for level-premium contracts. These types of contracts include individual disability income, long term care, and medical policies with issue age based rates. Vision does not write these types of coverages. Therefore, it is appropriate that no reserves have been set aside for this provision.

Premium Deficiency Reserves / Additional Reserves Due To Asset Adequacy Testing

These reserves are established if it is determined that a block of business requires reserves in addition to what has already been established. There are two similar reserve provisions that could be established:

1. Premium Deficiency Reserve (PDR)

- A PDR is established when future premiums and current reserves are not sufficient to cover future claim payments and expenses for the remainder of a contract period.
    - o The focus on the contract period makes this a short-term view of the reserve adequacy.
- A common situation for a PDR is a block of business that is unprofitable.

2. Additional Reserves Due to Asset Adequacy Testing
    - These reserves are established when future premiums and current reserves are not sufficient to cover future claim payments and expenses that are expected to be paid for the policies in force.
        - o The focus on all expected premiums and claims makes this a long-term view of the reserve adequacy.

Premium Deficiency Reserves

In Vision's 2007 Actuarial Opinion, a premium deficiency reserve of $712,000 was established. The deficiency reserve is in addition to claim reserves and contract reserves. The deficiency reserve is also in addition to rate stabilization reserves, retroactive premium liabilities, provider reserves, provider withhold or bonus pools, and other reserves not held to specifically make future benefit payments.

Vision calculated the premium deficiency reserves as the sum of future paid claims and future expenses less the sum of future earned premium and investment income. We believe this is an appropriate method for calculating the premium deficiency reserve for Vision.

The American Academy of Actuaries Premium Deficiency Reserves Discussion Paper of March 2007 states that the PDR supports the objective to aid in the measurement of a reporting entity's financial condition in that:

- The PDR is a tool for solvency regulation, helping to ensure that a reporting entity's contractual obligations will be adequately funded;
- The PDR accomplishes that purpose by establishing a reserve that reduces the reporting entity's statutory capital and surplus, by an amount equal to the excess of future contracted benefits and associated expenses over future revenues and current contract reserves;
- The PDR helps identify situations where the reduction in statutory surplus could result in potential impairment with regard to the reporting entity's ability to meet its obligation.

As stated above, a PDR is established when future premiums and current reserves are not sufficient to cover future claim payments and expenses for the remainder of a contract period. Considerable judgment must be used in determining the appropriate "contract period".

SSAP #54 – *Individual and Group Accident and Health Contracts*, states that deficiency reserves should be established for, "the remainder of the contract period". The implicit assumption is that premiums will be increased at the beginning of the new contract period, and will be adequate to cover claims and expenses in the new period.

NAIC's Health Insurance Reserves Model Regulation (HIRMR) states that a Gross Premium Valuation, which is the method to calculate a PDR, should take in to account, "all expected benefits unpaid... and all unearned premiums or expected premiums, adjusted for future premium increases reasonably expected to be put into effect."

The NAIC *Health Reserves Guidance Manual* (HRGM) states, "The apparent contradiction between these two requirements must be resolved using actuarial judgment. The actuary must consider realistic assumptions regarding lapsation, rate increases, and claims trend."

For our review of Vision's PDR provision there were several considerations:
1. The definition of "contract period" for Vision's policies;
2. The definition of "contract grouping" for the PDR calculation;
3. The actuarial assumptions of the PDR calculation.

Contract Period

A deficiency period is defined for any block where the internal calculations reveal future premiums and current reserves are not sufficient to cover future claim payments and expenses for the remainder of a contract period. Based on the assumptions in Vision's PDR calculation revenue will exceed expenses in year 2011. Therefore, the contract period for the PDR calculation is three years.

We believe this is a reasonable assumption for this type of business.

Contract Grouping

North Dakota Vision Services, Inc. provides vision services through two different mechanisms, fully insured and self funded. For the purpose of determining the PDR Vision projected the net subscriber income and incurred claims by three different categories: Self-Funded, Fully Insured and Healthy Steps (which is also fully insured). The operating expenses and the other income were reported in aggregate for the company.

The NAIC HRGM states, "Premium deficiency reserves should be determined for distinct groupings of policies. Generally, the grouping should reflect how the premium rates are developed and applied. This will usually result in groupings by product type and case size. Other criteria that may be considered include, but are not limited to: marketing methods (e.g., direct marketing vs. agent/broker sales), geographical rating areas, and length of rate guarantee periods, to the extent that such criteria materially affect premium rates."

Furthermore, the NAIC *Accounting Practices and Procedures Manual* Statement of Statutory Accounting Principles No. 54 (SSAP 54) "For purposes of determining if a premium deficiency exists, contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured."

The method Vision used for contract grouping was based on the HRGC section of Applicable Lines of Business. "A deficiency reserve may be needed on any of the following specified lines of business: comprehensive medical, Long-Term Care Insurance, Income Protection Insurance and Limited Benefit plans." Vision grouped the PDR calculation based on the belief that all of the business is contained in one specified line of business.

Although the HRGM does state that in some cases the end result is that the entire health business can be treated as a single grouping (the method Vision used), we believe that this is not a reasonable approach for Vision.

The contract grouping utilized by Vision fails to reflect the:

1. The difference in the risk associated with the self-funded and fully insured businesses;
2. The 2007 Annual Statement for Vision does not record the Self-funded premium, income and expenses;
3. The HRGM states that under certain circumstances, SSAP No. 5 requires a liability similar to Premium Deficiency Reserves for Administrative Services Only (Self-Funded plans) when the administrative fees are not sufficient to cover expenses for the remainder of the contract period.

Actuarial Assumptions

The HRGM provides an overview of the considerations used in creating the assumptions used in calculating the premium deficiency reserves. The critical assumptions selected by Vision for the PDR calculation were:

1. Premium Rate Increases and;
2. Expenses.

<u>Premium Rate Increases:</u> Reasonable rate increases and any market and regulatory restrictions on rates should be considered in establishing deficiency reserves. Assumptions for future rate increases should be reasonable, considering assumptions for future levels of claim cots.

Vision assumed the following rate increases for the fully insured business: 10% on 5/1/2008; 10% on 1/1/2009 and 10% on 1/1/2010. The method used to apply the rate increases was based on renewal dates such that contracts that renewed in February 2008 would be subjected to both the 10% rate increase on 5/1/2008 and 1/1/2009 when they renewed in February of 2009.

We validated the method used and believe the method is reasonable. However, the aggregate increase is 30% over current rates for the fully insured plans. We note that if the rate increases are not granted the premium deficiency reserve would be insufficient and or the contract period could extend past three years. We note that a 10% increase per year is plausible and reasonable but that the rate increases might cause adverse selection. The PDR calculation does not consider anti-selection or increased lapses.

Expenses: The expenses considered for a particular grouping should represent a reasonable allocation of all the reporting entity's expenses.

Vision reported the Operating expenses in aggregate for the company. The PDR documentation provides the most recent year of expenses and the projected expenses for Vision over the contract period.

Actual 2007 operating expenses	1,033,000
Projected 2008 operating expenses	1,064,000
Projected 2009 operating expenses	1,138,000
Projected 2010 operating expenses	1,218,000

In order to balance the Actual 2007 operating expenses to the expenses reported in the 2007 Annual Statement the administrative fees for the self-insured plans need to be included.

2007 Annual Statement Underwriting and Investment Expenses:

Gross Administrative Fees	258,570
Cost Containment Expenses	34,125
Other Claim Adjustment Expenses	161,577
General Administrative Expenses	610,020
Total Expenses	1,064,474

Actual 2007 operating expenses (PDR)	1,033,000
Difference	31,474

The documentation provided did not enable us to verify that the Gross Administrative fees are the actual expenses for administering the self-funded plans.

Vision provided a one page document that was applicable to all self-funded plans. The document stated that the administrative fees are determined by group size (8.4% of claims for groups < 50, 4.9% of claims for groups > 1000) if they contain a combination of health, dental and vision and 10% of claims for a vision only self-funded plan.

The fee schedule provided is in effect the basis for what each group is charged. We requested additional information of the actual expenses the Company incurs in administering the self-funded plans.

The Company stated the following in response to our request for additional information regarding self-funded expenses:

1. The Company assumes that the expenses are set equal to the fees;
2. Fee revenue equals the expenses of administering for self-funded business;
3. The marginal expenses are small for self-funded plans;
4. North Dakota Vision Services, Inc. is a Vision Service Corporation. Noridan Mutual Insurance Company provides administrative services under contract for Vision enrollment and benefits. The fees are transferred according to the fee schedule.

The Company made these statements but did not provide additional support or documentation. The annual statement contains individual expense line items in order to review the expenses of the fully insured plans. There is not a break-down of the components of the self-insured plans.

A review of the expenses for the self-insured plans compared to the fully insured plans reveals a large difference in the percentages charged to the self-insured plans compared to the actual expenses of the fully insured plans for 2007.

Plan	Expenses	Income	Expense Ratio
Self-Insured	258,572	2,359,491	11.0%
Fully Insured	774,428	2,992,737	25.9%

Vision did not demonstrate or elaborate as to how they were able to administer the self-funded plans for 11.0% of premium when the cost of the fully insured plans is 25.6% of premium.

The PDR calculation also reveals that the operating expenses of the Company will increase in 2008, 2009 and 2010. However, the operating expenses as a percentage of income for the fully insured plans are assumed to drop in each year.

Fully Insured Operating Expenses (Includes Fully Insured + Healthy Steps)

Year	Expense Ratio	Assumed Savings
2007 (Actual)	25.9%	
2008 (Projected)	24.1%	1.8%
2009 (Projected)	22.7%	1.4%
2010 (Projected)	22.0%	0.7%

Vision did not provided documentation as to how they would reduce the expenses during the contract period. We also note that the loss ratio of the fully insured plan is 80% in 2010. The loss ratio plus the expense ratio is greater than 100%.

IV. Premium Deficiency Reserve as of 12/31/2007

We reviewed Vision's PDR projections and the calculations which determined the premium deficiency reserves of 712,000 for 12/31/2007. We believe the projection does not comply with the contract grouping provisions of NAIC HRGM. We also believe that the expense assumptions are not adequately documented. In order to recalculate a premium deficiency reserve for 12/31/2007 we made the following assumptions:

1. The assumed investment income during the contract period is reasonable and appropriate;
2. The net subscriber income and assumed rate increases for the Fully Insured plans and Health Steps are reasonable and appropriate;
3. The incurred claims for the self-funded and fully insured and healthy steps plans are reasonable and appropriate;
4. *The expense savings for the fully insured plans are limited to 0.75% per year.*

Vision stated that there is not an additional charge for the vision self-funded plans for profit. However, even with operating expenses over 25% for the fully insured plans and continuing losses it appears as though the fully insured plans may subsidize the self-funded plans.

We assumed that all other assumptions in the PDR calculation are reasonable except that the expense savings will be limited to 0.75% per year.

Fully Insured Operating Expenses (Includes Fully Insured + Healthy Steps)

Year	PDR Vision Expense Ratio	Revised Expense Ratio
2007 (Actual)	25.9%	
2008 (Projected)	24.1%	25.1%
2009 (Projected)	22.7%	24.4%
2010 (Projected)	22.0%	23.6%

Recalculate Premium Deficiency Reserves as of 12/31/2007

To recalculate the PDR as of 12/31/2007 based on our revised operating expenses we changed the aggregate expenses to reflect the revised expense percentages for the fully insured plans. We assumed that the subscriber income, incurred claims and other income are equal to the original PDR calculation.

Revised PDR

Year	PDR Original	Change In Expense	PDR Revised
2008	411,000	34,917	445,917
2009	221,000	68,874	289,874
2010	80,000	68,070	148,070
Total	712,000	171,861	883,861

Based on our review of the methods, assumptions, and contract period, and interpretation of Vision's premium deficiency reserve development, we believe that the PDR reserve as of 12/31/07 is not sufficient.

If the Company was not able to reduce the expenses and the expense percentages during the next three years was 25.9% of fully insured plans the PDR would need to be 332, 983 greater than 712,000.

For future financial statements, the Company should follow statutory guidance provided in the following materials:

- NAIC's Statements of Statutory Accounting Principles, Number 54;
- NAIC's 2007 Health Reserves Guidance Manual;
- American Academy of Actuaries' Premium Deficiency Reserves Discussion Paper.

V. Premium Deficiency Reserve as of 6/30/2008

Our assignment was to review the adequacy of the following actuarial liability item in Vision's Quarterly Statement as of June 30, 2008:

1. Aggregate health policy reserves (Page 3, Line 4) $271,479

The NAIC HRGM states, "..(premium deficiency) reserve should be reviewed at least annually and adjusted as necessary. Valuations may be done monthly, quarterly, or any time frame that the actuary determines is reasonable. As of the date of each successive statutory financial statement, the premium deficiency reserve must be adjusted to reflect the losses that have been realized and any new deficiencies that have arisen. With respect to previously existing deficiencies, the actuary may judge that a previously established amortization schedule continues to be appropriate, and adjust the reserve in accordance with that amortization schedule without reevaluating the reserve from basic financial data. The use of the term "amortization" is intended to permit modification of a prior deficiency reserve amount for quarterly reporting rather than require recalculation of the reserve based on underlying data each time."

The PDR establishes a reserve that reduces the reporting entity's statutory capital and surplus, by an amount equal to the excess of future contracted benefits and associated expenses over future revenues and current contract reserves. If the business were to follow the pattern present in the assumptions presented in the PDR calculation could be estimated using at each year end:

	PDR	Calendar Year
12/31/2007	712,000	Losses
12/31/2008	301,000	411,000
12/31/2009	80,000	221,000
12/31/2010	0	80,000
		712,000

We estimated the PDR as of 6/30/2008 based on the assumptions that the Calendar year losses were set equal to 1/2 of the projected losses:

PDR as of 12/31/2007	712,000	
½ Calendar year 2008 losses	205,500	(.5* 411,000)
PDR as of 6/30/2008 (estimate)	506,500	
Quarterly Statement PDR	271,479	
Difference	(235,021)	
Recognized losses for 2008	440,521	(712,000 – 271,479)

The company did not provide support or documentation for the development of the PDR as of 6/30/2008. However, the June 2008 company financials reveals loss ratios that exceed the assumed loss ratios in the PDR calculation.

Year	PDR Projected Loss Ratio	Actual Loss Ratio through 6/30/08
Self-Funded	89.0%	91.2%
Fully Insured	90.3%	94.3%

We note that if the loss ratio for the fully insured plans continued at the 94.3% level compared to the 90.3% assumed in the PDR calculation this would create an additional 132,000 in losses that were not considered in the original PDR calculation of 12/31/2007. If the loss ratio for the self-funded plans continued at the 91.2% level compared to the 89.0% assumed in the PDR calculation this would create an additional 60,000 in losses that were not considered in the original PDR calculation of 12/31/2007.

Based on the fact that the PDR as of 6/30/2008 has recognized more losses through June 2008 than were originally projected for the entire calendar year and the fact that the loss ratio is higher than predicted we believe the PDR as of 6/30/2008 does not reflect new deficiencies that have arisen.

VI. Summary

We made the following observations regarding the adequacy and reasonableness of the Company's Premium Deficiency Reserves reported in the 2007 Annual Statement:

- The Company failed to adhere to the NAIC's *Health Reserves Guidance Manual* when developing the contract groupings in establishing a premium deficiency reserve.
- The Company failed to provide the support and documentation of the expenses assumed in the calculation of the premium deficiency reserve.
- Vision's aggregate health policy reserves as of 12/31/2007 were understated by $172,000.
- Vision's aggregate health policy reserves as of 6/31/2008 did not reflect new deficiencies that have arisen.

Brian D. Rankin
Vice President & Consulting Actuary
Lewis & Ellis, Inc.

November 4, 2008